



Missouri Division of Finance

UPDATE

A Report of Missouri State Chartered Financial Institutions

Issue 00-2

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From . . .
Acting Commissioner
Eric McClure

I am excited that "financial modernization" is here which will allow new and significant opportunities for our banks. There will also be certain challenges associated with these opportunities as the Missouri financial industry enters this new era. I am confident that our industry will accept these challenges and strive for quality service to our citizens while maintaining the safety and soundness of its institutions.

I am pleased to report that, overall, the Missouri state chartered banks continue to be in good financial condition. Capital and reserve levels are strong and the industry's earnings are good. Even though the economy has been good, a tightening of the liquidity positions is continuing as a result of fierce competition for deposits. More of our banks are looking for alternative funding sources such as those provided by the FHLB. It takes far greater sophistication in bank's policies, procedures and planning to successfully operate in this much more competitive environment.

We are proud to announce that we were able to lower the assessments for our state chartered banks again for the third consecutive year. We will continue our efforts at looking for efficiencies in our operations.

We hope this edition of the UPDATE will be of value to you. We welcome feedback regarding what you would like to see in future editions. Be sure to visit our website at www.missouri-finance.org.

GENERAL USURY

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accordance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period October 1, 2000 through December 31, 2000 shall be 9.0%; as an alternative, 10% may be used.

In This Issue:

- **Examiner Review of Internet Banking**
- **Survey of Revenue Producing Services**
- **New State Chartered Banks**

THE KINDS OF CONSUMER CREDIT -- A PRIMER

As the licensing statutes have very little effect on banks, most bankers give little thought to the various types of consumer credit even as they extend these varieties in their daily business. That which follows is an overview of the laws related to the different types of consumer credit commonly extended by banks.

Consumer credit loans: This is the giant area of lending found within sections 408.100-408.210; this is where auto loans, boat loans, consolidation loans and most anything else is found. There is a 5% not-to-exceed-\$50 fee available along with an unlimited contract rate of interest. Late charges may be charged after 15 days in an amount of 5% of the past due payment not to exceed \$25 but with a minimum of \$10 unless the payment is \$25 or less when the maximum late charge is \$5. Refunding may be under the rule of 78s unless the original contract has a term exceeding 61 months which requires a simple interest contract. All consumer provisions per sections 408.551-408.562 apply.

Motor vehicle time sales: This is third party paper, i.e., there is no loan; the law, Chapter 365, can be directly used by a bank only if the bank owns the vehicle (e.g. a repo or fleet vehicle). The act permits a rate of \$10 per hundred per year on vehicles two years old and newer and \$13 per hundred per year on older vehicles; these are not APRs but add-on rates which will give a varying APR depending on the term. Very big exception: if the cash sale price exceeds \$7,500, the act does not apply and the maximum rate is 24% APR. Late charges equal to the lesser of 5% of the past due payment or \$5 are available after 10 days. Refunding may be by the rule of 78s unless the original term of the contract exceeds 61 months which requires a simple interest contract. The consumer provisions of sections 408.551-408.562 apply to any contract made under the act.

Retail credit sales: This is dealer paper for merchandise other than automobiles and the substantive law is found at sections 408.250-408.370. There are no fees available, but any contracted rate of interest is lawful. A flat \$10 late charge is available after 10 days unless the payment due is less than \$25 in which case the late charge is limited to \$5. Refunding may be by the rule of 78s unless the original term exceeds 61 months which requires a simple interest contract. The consumer provisions of sections 408.551-408.562 apply to any contract made under the act.

First deed of trust residential real estate loans: These are deregulated on rate and points (anything that goes into the finance charge and APR) by Title V of PL 96-221. Other fee limitations are found in section 408.052. The only limit on late charges is that there must be at least 15 days grace. Prepayment penalties are limited to 2% and only in the first 5 years.

Second deed of trust residential real estate loans: These have a deregulated contract rate and may call for points not to exceed 5% of the principal. Late charges of the lesser of 5% of the payment or \$25 are available after 15 days grace. Prepayment penalties may not exceed 2% and are available only in the first 5 years. The consumer provisions of section 408.551-408.562 apply.

Insurance premium finance: These transactions are covered by sections 364.100-364.160 and a license is required for a bank to engage in this activity. A flat \$10 per contract fee may be charged and the maximum contract rate is \$15 add-on which results in an APR that will vary slightly with the term but will approximate 26% APR. A late charge of 5% not to exceed \$15 is available after 5 days delinquency. Refunding may be by the rule of 78s

Assessments - Efficiencies Pay Off

The assessment rate used by the Missouri Division of Finance dropped for third consecutive year due to various efficiencies we have been able to implement. The average cents/\$1,000 in assets for the last four fiscal years are as follows:

FY98	19.9 cents/\$1,000	FY00	16.7 cents/\$1,000
FY99	17.1 cents/\$1,000	FY01	15.5 cents/\$1,000

EXAMINER REVIEW OF INTERNET BANKING



Missouri community banks are rapidly joining the internet revolution. For most the question is not *whether* to offer online banking, but *when*? Our June 30, 2000, survey of banking services shows 127 state banks are using the internet (41% of survey respondents) as part of their promotion strategy. The level of internet activity is summarized as follows:

54% <i>Informational</i>	Nontransactional, advertising and information.
5% <i>Communication</i>	As above, plus customers can view account balances, e-mail.
41% <i>Transactional</i>	As above, plus customers can initiate account transactions such as transfers, loan payments and bill payments.

The step into internet banking brings new opportunities and challenges for bank managers together with new risks that must be carefully evaluated. Bank examiners will be reviewing management's internet strategy, implementation, and controls. Most community banks are purchasing internet packages from outside vendors. Here are some of the fundamentals that will receive examiner attention when a bank provides internet services through a third-party vendor:

- Planning – How does internet banking fit into the business strategy? Has the Board of Directors discussed and approved plans? Is there a process for updating strategic direction? What market area is the bank targeting with on-line products and services?
- Implementation – Has the board adopted an electronic banking policy? Have other policies been updated to address this new activity? Who are the key individuals in the bank responsible for internet banking? Do they have adequate time, knowledge and skill to manage this area? Was a due diligence review performed in selection of the vendor that included an evaluation of its financial viability, reputation and capability to meet current and future needs? Is electronic banking coverage included in the fidelity bond?

(over)

- Legal and Regulatory – Are vendor and bank responsibilities clear? What are the contract provisions for independent audits, security of bank information, ownership of data, cancellation and assignment of the contract? For transactional internet activities, has the bank provided the Division of Finance with an examination agreement per Section 362.105 RSMo? Does the site provide proper disclosures for advertising of FDIC insurance and nondeposit investment products?
- System Integrity - Did the bank test the internet system to assure its capabilities and capacities? Are proper levels of security and authorization in place? How is access to sensitive information determined and controlled? How is the confidentiality of the bank's data and privacy of customer information protected? Is physical access to computer hardware, software and communication equipment restricted? Are virus detection and prevention programs installed? Does the bank and/or vendor have back-up plans to replicate service in the event of disruption?
- Audit and Controls – Does the external or internal audit scope include internet operations? Has the bank received and reviewed the vendor's outside audit report? Has management reviewed the regulatory examination report of the vendor (available from you federal bank regulator)? What is the process to verify customer transactions? Does management receive reports on attempted intrusion of the system? Does management monitor performance reports concerning customer problems, transaction volume and capacity reports?

For more regulatory information on internet banking, an excellent starting point is the Federal Reserve Bank of Kansas City's website: www.kc.frb.org/bs&s/ebanking.htm.

INTERNET BANKING REMINDER

State chartered banks and trust companies with transactional websites provided by an outside vendor are required by Section 362.105.1(11) RSMo to provide the Division of Finance with a *Data Service Provider Examination Agreement*. The form can be obtained from the Division's website (www.missouri-finance.org), or call Cathy Burks at our Jefferson City office (573-751-3395).

MISSOURI DIVISION OF FINANCE BANK SECURITIES BROKERAGE SUMMARY

The Gramm-Leach-Bliley Financial Modernization Act, passed by Congress in late 1999, authorized a variety of new activities for banks in the securities and insurance fields. Although Missouri banks, trust companies and savings banks already possessed many of the new powers, Missouri enacted a law this summer that authorized the remaining powers for Missouri institutions. Because the Division of Finance routinely gets questions from bankers about what types of "financial modernization" powers are available for their charters, we have prepared the summary below as a short review of the current status of one of the most commonly sought financial modernization powers: securities brokerage.

The following is a brief summary of the current powers of Missouri state chartered banks, trust companies and savings banks to conduct securities brokerage activity.

Direct Discount Brokerage - All Missouri state chartered banks, savings banks and trust companies (both depository or nondepository) can directly sell investment securities, without recourse, solely upon order and for the account of customers. This power is also available through a regular operating subsidiary. Operating subsidiaries require no approval by or filings with the Division of Finance. Operating subsidiaries are different from the newly authorized "financial subsidiaries" created by Gramm-Leach-Bliley or the "securities subsidiaries" authorized under 4 CSR 140-2.130, which are discussed below and have special regulatory requirements. Banks, savings banks and trust companies that have fiduciary powers can also provide full fiduciary advice to trust customers to carry out fiduciary duties under a trust, but cannot advertise or hold themselves out to the public as providing direct investment advice on securities matters except in carrying out trustee duties.

Financial Subsidiary and Securities Subsidiary Full Brokerage - All Missouri state chartered banks, savings banks or trust companies (either

depository or nondepository) may establish a "financial subsidiary" or a "securities subsidiary" to conduct full brokerage activities, including investment advising. A financial subsidiary is a new type of subsidiary created by Gramm-Leach-Bliley that is subject to certain regulatory requirements, such as capitalization standards and other safety and soundness considerations of the Division. A securities subsidiary is a special type of subsidiary authorized by 4 CSR 140-2.130, which is subject to approval by the Division and to capitalization standards and other safety and soundness considerations of the Division.

Third Party Contract for Brokerage - All Missouri state chartered banks, savings banks or trust companies (either depository or nondepository) may contract with a third party which could conduct full or discount brokerage at any office of the institution. The third party could be an unaffiliated entity, an affiliate company or a holding company. These contracts may be subject to certain insider and related entity restrictions, such as 4 CSR 140-2.110 and Section 23B of the Federal Reserve Act.

**** Securities Licensing and Registration Requirements ****

Whenever securities are sold through any type of brokerage activity to customers at a bank, trust company or savings bank office, including through a third party contract, Missouri or federal law may require brokerage registrations or licenses to be held by the bank, trust company or savings bank, as well as any affiliate or subsidiary involved. In addition, the institution and its affiliates should always be careful to verify that each agent making sales of securities products from the institution's premises is appropriately licensed or registered with the Missouri Securities Division and the Securities and Exchange Commission. The Missouri Securities Division has recently issued an opinion letter stating requirements for bank contacts with third parties for brokerage activity. You can get a copy of this letter by contacting the Division of Finance.

MISSOURI DIVISION OF FINANCE BANK INSURANCE AGENCY ACTIVITIES SUMMARY

The Gramm-Leach-Bliley Financial Modernization Act, passed by Congress in late 1999, authorized a variety of new activities for banks in the securities and insurance fields. Although Missouri banks, trust companies and savings banks already possessed many of the new powers, Missouri enacted a law this summer that authorized the remaining powers for Missouri institutions. Because the Division of Finance routinely gets questions from bankers about what types of "financial modernization" powers are available for their charters, we have prepared the summary below as a short review of the current status of one of the most commonly sought financial modernization powers: insurance agency.

The following is a brief summary of the current powers of Missouri state chartered banks, trust companies and savings banks to conduct insurance agency activity. The summary is arranged so that you can identify your institution's type of charter and the precise type of activity or fact pattern that applies.

Missouri State Chartered Bank

Direct Bank Sales – The following powers are available directly by the bank or through a regular bank operating subsidiary. Operating subsidiaries require no approval by or filings with the Division of Finance. Operating subsidiaries are different from the newly authorized "financial subsidiaries" created by Gramm-Leach-Bliley, which are discussed below and have special regulatory requirements.

Credit and Title Insurance Sales – All Missouri state chartered banks can sell credit related insurance, such as credit life insurance and title insurance, in connection with the bank's lending activities.

Insurance Sales from Towns of 5,000 – All Missouri state chartered banks can sell all types of insurance from any office located in a place of 5,000 population or less.

Bank Financial Subsidiary Sales - All Missouri state chartered banks may establish a "financial subsidiary" to sell any type of insurance from any office in any town of greater than 5,000 population. A financial subsidiary is a new type of subsidiary created by Gramm-Leach-Bliley that is subject to certain regulatory requirements, such as capitalization standards and other safety and soundness considerations of the Division.

Third Party Contract for Insurance Sales – All Missouri state chartered banks may contract with a

third party which could sell all types of insurance to customers at any office of the institution, regardless of population of the area. The third party could be an unaffiliated entity, an affiliate company or a holding company. These contracts may be subject to certain insider and related entity restrictions, such as 4 CSR 140-2.051 and Section 23B of the Federal Reserve Act.

Missouri State Chartered Trust Companies and Savings Banks

Direct Sales – All Missouri state chartered trust companies, either depository or nondepository, and Missouri savings banks may sell any type of insurance from any office of the institution, regardless of population of the area. These institutions do not have to create a financial subsidiary to perform these activities, but could use an operating subsidiary if desired.

Third Party Contract for Insurance Sales – All Missouri state chartered trust companies, either depository or nondepository, and savings banks may contract with a third party which could sell all types of insurance to customers at any office of the institution, regardless of population of the area. The third party could be an unaffiliated entity, an affiliate company or a holding company. These contracts may be subject to certain insider and related entity restrictions, such as 4 CSR 140-2.051 and Sections 23A and 23B of the Federal Reserve Act.

**** Insurance Licensing Requirements ****

Whenever insurance is sold to customers at a bank, trust company or savings bank office, including through a third party contract, Missouri law may require insurance agency licenses to be held by the bank, trust company or savings bank, as well as any affiliate or subsidiary involved. In addition, the institution and its affiliates should always be careful to verify that each individual agent making sales of insurance from the institution's premises is appropriately licensed.

SURVEY OF REVENUE PRODUCING SERVICES

The Division of Finance surveyed state-chartered banks and trust companies in July 2000 to obtain a picture of the number of institutions that participate in the many nontraditional revenue producing activities that banks enjoy. The results are derived from 313 institutions, a response rate of 96 percent. We appreciate the time and effort of bank personnel who participated in the survey. The following is summary of the survey results:

ACTIVITY	AFFIRMATIVE RESPONSE
TRUST SERVICES	
♦ Ability to offer full trust services	33%
♦ Serve as Originating Trustee	7%
INSURANCE SALES	
♦ Insurance products are available at the institution	26%
♦ Of those that offer such products, sales are effected by:	
The bank itself	40%*
Affiliate or holding co.	20%*
Bank subsidiary	21%*
Third party contractor	46%*
NONDEPOSIT INVESTMENT PRODUCTS	
♦ Securities, annuities or mutual funds products are available at the institution	32%
♦ Of those that offer such products, sales are effected by:	
The bank itself	44%*
Affiliate or holding co.	17%*
Bank subsidiary	12%*
Third party contractor	75%*
INTERNET ACTIVITY	
♦ Internet services available	41%
♦ Of those that offer such products, the level of website activity is:	
Informational only	54%
Communication/View accounts	5%
Transactional	41%
OTHER ACTIVITY	
♦ Real Estate Development Corporation, Community Development Corporation, Collection Agency, Credit Bureau, Tax Service, Residential Mortgage Loan Company	8%
NEW ACTIVITIES FROM FINANCIAL MODERNIZATION (GRAMM-LEACH-BLILEY)	
♦ Holding company plans to become a "Financial Holding Company"	16%
♦ Bank plans to establish a "Financial Subsidiary"	6%

* Several banks indicated sales are effected by multiple providers.

NEW STATE CHARTERED BANKS

There are two recent additions to the ranks of Missouri state chartered banks:

Charter number 2869 was issued to the **Bank of Franklin County**, 900 East Eighth Street, Washington, MO on July 5, 2000. Common stock \$1,000,000; surplus \$3,350,000.

Charter number 2870 was issued to **Arvest Bank**, 700 South Main Street, Joplin, MO on July 27, 2000. This effected a conversion from a federal savings bank charter to a state bank charter.

QUICK REFERENCE OF STATE LAWS AND REGULATIONS

This reference is designed as a summary of laws and regulations frequently reviewed during the examination process. The listing is not all inclusive of state banking statutes applicable to state-chartered banks and trust companies. Reference should be made to the actual statute or regulation for a thorough understanding of the subject.

RSMo 110.010 and 110.020 Deposits of Public Funds

Requires deposits of public entities to be fully secured by acceptable securities or a surety bond (net of FDIC insurance) as described in RSMo 30.270

RSMo 362.073 Change in Control

President notifies the Division of Finance, within one business day, anytime there is a 25% change in stock ownership or there is a change in voting control.

RSMo 362.105 Powers and Authority of Banks and Trust Companies

Details permissible activities for financial institutions and includes requirements for:

- 1) Prior approval of Division of Finance for purchase or lease of real estate.
- 2) Examination agreement for other entities to process or store data.

RSMo 362.165 Restrictions on Taking and Holding Real Estate

Real estate for debts previously contracted must be conveyed to bank directly and may be held for a maximum of ten years.

RSMo 362.170 Legal Lending Limit/Loans to Salaried Officers

Unimpaired capital is defined as capital notes, total equity capital, plus reserves not subject to known charges based on most recent Call Report. (SFAS 115 capital adjustment is also reversed. Goodwill, other intangibles are counted.)

Legal Lending Limit

Loans to any individual, partnership, or entity cannot exceed these percentages of unimpaired capital:

- 15% -bank located in a city of population of 100,000 or greater
- 20% - bank located in a city of population between 7,001 and 99,999
- 25% - bank located elsewhere
- 35% - if amount over the legal lending limit is collateralized by warehouse receipts for insured agricultural products stored in public storage facilities. Value of the collateral must exceed the loan amount by 15%.

Exceptions to legal loan limit:

- (1) Bonds or debt of U.S. government or any political subdivision in Missouri;
- (2) Bonds or debt guaranteed by the U.S. government;
- (3) General obligation bonds or debt of any other state, county, city, or school district with over 50M inhabitants which have not defaulted for more than 120 days on any general obligation debt in the last 10 years;

- (4) Loans insured or guaranteed by any agency of the U.S. government or the state of MO;
- (5) Notes secured by direct U.S. government obligation;
- (6) Loans secured by segregated deposit accounts in lending bank;
- (7) Direct obligations, loans guaranteed or collateralized by obligations of FFCB, FHLB, FHLMC, FNMA, GNMA, or SLMA.

Guarantees are not included if guarantor does not receive the proceeds. Corporate debt is not normally attributed to stockholders.

4 CSR 140-2.080 – Legal Loan Limit

Guidelines for aggregating debts of two or more borrowers considering: use of proceeds, structure of the enterprise, source of repayment, management control, and borrowers' interdependence.

4 CSR 140-2.081 – Legal Loan Limit – Limited Partnerships

Loans to partnerships are attributed in full to each general partner. In limited partnerships, full amount of the debt is attributed to the general partner, but not limited partners.

4 CSR 140-6.055 – Bank Investment in Mutual Funds

Investment in each mutual fund limited to legal loan limit. Fund portfolio comprised only of assets the bank could purchase directly.

Loans to Salaried Officers:

Aggregate loans to a salaried officer are limited to 10% of unimpaired capital to any individual and 25% to all salaried officers combined. Loans must have prior written approval by the board or executive committee and must be on the proper form. Loans to corporations are attributed to salaried officer if officer controls a majority of corporate stock.

RSMo 362.245 Qualifications of Board of Directors

Details requirements for Boards of Directors. The affairs of each financial institution will be managed by a board of 5 – 35 directors, who are elected annually. Each director must be a U.S. citizen. The majority of each board must reside in Missouri or within a 100 mile radius of the main banking house. Directors residing outside Missouri must complete a consent to service form. Cannot serve as a director if bank holds a judgment against him.

RSMo 362.247 Majority of the Board of Directors Constitutes a Quorum

Acts of a majority of the Board of Directors at a meeting at which a quorum is present shall be acts of the board unless a greater number is required by law, the articles of agreement or bylaws. Telephonic and video conferencing permissible for "1 and 2" rated banks, subject to statutory procedures.

RSMo 362.250 Oath of Directors

Shall be administered within 30 days of election and must be transmitted immediately to the Division of Finance.

RSMo 362.260 Vacancies in Board of Directors

Board vacancies shall be filled by the stockholders or vacancies not exceeding one-third of the whole number may be filled by the board by majority vote, until next shareholders' meeting.

RSMo 362.265 Change in the Number of Directors

The stockholders at any annual or special meeting can change the number of directors by a majority vote as long as the number remains between 5 and 35. The Board of Directors by a two-thirds majority vote can add up to two additional temporary directors between shareholder meetings. A copy of the resolution changing the number of directors shall be immediately filed with the Division of Finance.

RSMo 362.270 Organizational Meeting of the Board

An organizational meeting of the directors shall be held within 30 days after the annual stockholders' meeting at which directors are elected. At the organizational meeting, a president shall be elected from the Board and one or more vice presidents and other officers shall be elected as provided for in the bylaws.

RSMo 362.275 Lists to be Reviewed at Monthly Board Meetings

Board of Directors must review the following lists at each monthly meeting:

- (1) Aggregate loans created, extended, or renewed since the last list cut off date exceeding 5% of the legal loan limit but in no case less than \$10M;
 - (2) Aggregate indebtedness to borrowers whose debt exceeds 5 times the minimum amount but in no case less than \$50M;
 - (3) Loans past due 30 days or more;
 - (4) Indebtedness of all officers, directors, and employees. Guarantees and unfunded commitments are included in list (4).
- Collateral, if any, shall be described on each list (1-4).

Polling of directors is permissible to address matters requiring board action between formal meetings, provided the poll is ratified at the next regular board meeting.

RSMo 362.290 Communication from the Commissioner of Finance

Communication from the Division of Finance concerning an examination or containing suggestions as to the conduct of the bank shall be submitted to the Board at the next meeting and noted in the minutes.

RSMo 362.295 Reports to the Commissioner of Finance

Reports (Call Reports) shall be submitted to the Division of Finance, published in a local publication, and displayed in the main banking house in a location accessible to all. The publishing requirement will be waived if a notice is posted in the lobby that a copy of the report will be provided free of charge to all who request it.

RSMo 362.340 Employees to Give Bond

Directors approve insurance and bond program annually. Subject to the approval of the Division of Finance.

RSMo 447.505 and 447.539 Abandoned Property

Property is presumed abandoned if within the last five years no activity has occurred in deposit accounts and the bank has not had any contact with customer (including the customer accepting mail). Abandoned property must be reported to the State Treasurer by each November 1st as of the prior June 30th.

4 CSR 140-2.060 Investment in Fixed Assets

Division of Finance approval is required for purchase or lease of real property. Ordinarily, fixed assets, including real property, equipment and furniture, will be limited to less than 50% of unimpaired capital. Exception in 362.105 allows investment up to legal loan limit for banks with total assets of \$200 million or more.

4 CSR 140-2.070 Accounting for ORE

ORE shall be recorded at the lesser of fair market value or book value plus allowable expenses. Allowable expenses include: accrued interest, foreclosure costs (including legal fees), and expenses related to the improvement of the property's condition. Legal expenses incurred after foreclosure and expenses that maintain the value of the property should be expensed as incurred. Allowable expenses can be capitalized up to six months after transfer as long as the total book value does not exceed fair market value.

If ORE book value exceeds the lesser of 5% of unimpaired capital or \$50M, an independent qualified appraisal is required. Compliance is achieved if an appraisal was obtained six months prior to acquisition or an engagement letter is obtained within 30 days after foreclosure; however, the appraisal must be in file within 90 days.

4 CSR 140-2.110 Management and Other Fees Paid to Insiders

Fees paid to insiders must reflect fair market value and be properly documented and retained in permanent records.